

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Poochigian Analyst: Roger Lackey Bill Number: SB 719

Related Bills: See Prior Analysis Telephone: 845-3627 Amended Date: 05/03/01

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Health Insurance Costs Paid for Family Member Refundable Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

X AMENDMENTS DID NOT RESOLVE ALL THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 23, 2001.

X FURTHER AMENDMENTS NECESSARY.

X DEPARTMENT POSITION CHANGED TO Support.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 23, 2001, STILL APPLIES.

OTHER - See comments below.

SUMMARY

This bill would create a refundable tax credit for health insurance paid by a taxpayer for any member of the taxpayer's family that is eligible to receive benefits under the Healthy Families Program.

SUMMARY OF AMENDMENTS

The May 3, 2001, amendments do the following:

- Change the operative date from 2001 to 2002, and delay the sunset date from 2008 to 2009;
- Clarify that the credit is allowed based on health coverage for an individual and his or her spouse or dependent;
- Redefine "eligible amount";
- Specify that it is the Legislature's intent to appropriate "unexpended federal funds" for this credit, rather than "unspent moneys";
- Require that the Managed Risk Medical Insurance Board, in conjunction with the State Department of Health Services, seek any federal waivers necessary to implement this credit; and
- Specify this credit will only be implemented to the extent that federal financial participation is obtained.

These amendments resolve one of the department's implementation concerns by clarifying who qualifies for the credit. The department's administrative cost estimate and the remaining concerns stated in the department's analysis of the bill as introduced still apply and are included below.

Board Position:

| | | |
|------------------|-------------------|-----------------------|
| <u>X</u> S | <u> </u> NA | <u> </u> NP |
| <u> </u> SA | <u> </u> O | <u> </u> NAR |
| <u> </u> N | <u> </u> OUA | <u> </u> PENDING |

Legislative Director

Date

Brian Putler

05/22/01

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective upon enactment. However, this bill specifies that it would be operative for taxable years beginning on or after January 1, 2002, and before January 1, 2009.

POSITION

Support.

At its May 2, 2001, meeting, the Franchise Tax Board voted 2-0 to take a support position on this bill, with Annette Porini, on behalf of Member B. Timothy Gage, abstaining.

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the implementation concerns discussed below.

IMPLEMENTATION CONCERNS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill specifies that the individual or his or her spouse or dependent for which health insurance is provided must be eligible to receive benefits under the Healthy Families Program. It is unclear if claimants would be required to apply for eligibility in the Healthy Families Program to verify their eligibility prior to being allowed the credit. The department would have difficulty verifying that the claimant was "eligible" if the claimant does not actually apply and receive benefits.

The bill defines "eligible amount" as "an amount equal to the amount of the average per person allocation for a participant in the Healthy Families Program during the year preceding the taxable year." The department does not have a method to verify the average per person allocation. In addition, it is unclear if the taxpayer must actually have been a participant in the Healthy Families Program in the preceding year.

This bill requires that refunds be paid on a quarterly basis. FTB's current systems are programmed for annual processing and are unable to refund an amount in quarterly installments.

This bill also requires FTB to prescribe forms and an application procedure for this credit. It is unclear what information should be required on the application that would differ from information provided on the tax return. Further, for information that is not required to be provided by the statute but is requested on the application, FTB would be obligated to comply with the provisions of the Administrative Procedures Act and adopt regulations, which may delay FTB's ability to administer this credit on a timely basis.

Clarification is needed as to whether the application is to be filed with the tax return, which is filed annually, or if the application would be filed quarterly. If four applications are required (one per quarter), it is unclear if the taxpayer would need to qualify for each quarter separately or if the taxpayer would need to qualify for all four quarters. In addition, if the application would be filed quarterly, a deadline for filing the application would need to be identified.

If the intent is to require the application to be filed with the return, but the application is filed after the first quarter, clarification is needed as to whether the first quarter payment would be disallowed or whether the quarters begin when the application is filed. Clarification also would be needed for applications with returns filed late due to automatic extensions.

The bill specifies that the individual or his or her spouse or dependent for which health insurance is provided must be eligible for the Healthy Families Program. Part of the criteria to qualify for eligibility in the Healthy Families Program requires the applicant to have an annual or monthly household income equal to or less than 250% of the federal poverty level. Most of these taxpayers do not have a state income tax filing requirement, but would be forced to file an income tax return to receive the benefit of the refund provided under this proposed credit.

According to the 2000 U.S. Department of Health and Human Services Federal Poverty Guidelines, the poverty guidelines are sometimes loosely referred to as the "federal poverty level." However, that term is ambiguous and should be avoided in situations (e.g., legislative or administrative) where precision is important. There are no universal administrative definitions of "family," "family unit," or "household" that are valid for all programs that use the poverty guidelines. The absence of a definition that identifies the author's intent complicates the administration of this credit.

The 2000 U.S. Department of Health and Human Services Poverty Guidelines indicate the following (not including Alaska and Hawaii):

| Size of Family Unit | 48 Contiguous States and D.C. | x 250% |
|------------------------|----------------------------------|----------|
| 1 | \$8,350 | \$20,875 |
| 2 | \$11,250 | \$28,125 |
| 3 | \$14,150 | \$35,376 |
| 4 | \$17,050 | \$42,625 |
| 5 | \$19,950 | \$49,875 |

For each additional person add \$2,900.

Since the "federal poverty level" generally refers to more than one individual, it is unclear how the taxpayer or the department would determine eligibility for the credit. For example, it is unclear how the income of the other members of the household that are not family members would affect the taxpayer's eligibility for the credit.

The department has no ability to verify household or family income. Tax benefits, such as the renters' credit, generally are tied to the adjusted gross income (AGI) amount, with a maximum AGI for qualifying married couples filing a joint return and heads of household and a lower maximum AGI for qualifying single filers.

Administration of the credit may be less difficult if:

- the quarterly application procedure was eliminated;
- applicants were required to actually apply for the Healthy Families Program, rather than just be "eligible"; and
- the Healthy Families Program was required to provide the department with a list of eligible applicants for verification purposes.

This bill would require regular appropriations by the Legislature to pay for the refundable portion of this credit. If sufficient funds were not appropriated to cover all of the refunds due, the department would suspend payment of the refunds until additional funds were appropriated. This delay would result in additional contacts to the department by refund recipients, which would likely increase departmental costs.

The proposed credit under this bill would be claimed by low-income individuals. Low-income individuals generally file their tax returns on Forms 540A or the postcard-size 540 2EZ. To minimize the complexity of the Form 540 2EZ returns, the only credit allowed on this form is the nonrefundable renters' credit. The department could not add this proposed credit to the Form 540 2EZ as this form does not accommodate attached schedules due to its size. As a result, taxpayers that would normally file on Form 540 2EZ would be required to file on the more complex Form 540A to claim the credit.

Since the proposed credit is refundable, the credit would need to be shown in the payment section on all personal income tax (PIT) returns except the Form 540 2EZ. This would increase PIT return Forms 540, 540NR, 540X, and potentially the 540A by one page. Adding a page to these forms would result in a significant impact on FTB's operations and costs, would slow return processing, and would increase the amount of return storage space. The department would work within available space to the extent possible but may be required to lease additional office and file storage space to store larger returns and the additional returns generated by this credit.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved, but are expected to be about \$7 million and in excess of 200 personnel years.

ECONOMIC IMPACT

Tax Revenue Estimate

Based on very limited data and assumptions discussed below, this bill would result in minor revenue losses annually (less than \$500,000) under the Personal Income Tax Law, possibly reaching the level of \$1 million annually beginning in 2004-05.

Revenue Estimate Discussion

The revenue impact of this bill would be determined by the amount of credits reported on tax returns or other application procedure and forms as required.

The May 3, 2001, amendments change the effective date of the proposed refundable tax credit from 2001 to 2002. Changing the effective date to 2002 results in a smaller differential between individuals eligible to participate in the HFP and those who are actually enrolled due to an additional year's normal program growth. The average per person allocation also reflects an additional year's growth.

The number of taxpayers who would report the credit is expected to be very limited. Participation is anticipated to be minimal due to the necessity of taxpayers having to first pay monthly premiums out-of-pocket and later obtain a refund. Any likely participants would probably be from the group who is eligible but not currently enrolled in the Healthy Families Program (HFP). It is assumed that those who already participate in the HFP would not terminate participation for this proposal.

According to contacts at the Managed Risk Medical Insurance Board, the differential between individuals eligible to participate in the HFP and those who are actually enrolled is projected at 150,000 in 2002. Assuming this converts to roughly 85,000 family units or taxpayers, participation is not expected to be significant, perhaps reaching 1% of this group by the third year. Assuming this level of participation and an average per person allocation of \$1,175 would derive credits of \$1 million by the third year.

ARGUMENTS/POLICY CONCERNS

This bill may not achieve the author's intent for low-income families to access funds in order to independently purchase health care. The proposed credit would first be used against the taxpayer's tax liability, then offset against other amounts due, and then any remaining amount would be refunded to the taxpayer. There is an assumption reflected here that federal money from the Healthy Families Program would be available to fund the refundable portion of this credit. Unless there is clear federal authority to support that conclusion, this bill may not be able to accomplish this purpose.

Historically, refundable credits such as the prior state renter's credit and the federal Earned Income Credit have had significant problems with invalid and fraudulent returns. These problems are aggravated if a refund is made that is later determined to be fraudulent since the refund commonly cannot be recovered.

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